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UNCLAS SECTION 01 OF 03 BEIJING 000702

SENSITIVE
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STATE FOR EAP/CM -- FLATT
STATE FOR EEB/OIA -- SCHOLZ, TRACTON, HICKS, YAJNIK
STATE FOR E -- YON
STATE FOR D -- PARK
STATE FOR L -- CAPLAN
STATE PASS USTR FOR STRATFORD, WINTER, BAHAR, KALLMER
STATE PASS FTC FOR KALLAY, TRITELL, DAMTOFT
NSC FOR LOI
DOJ FOR CHEMTOB
TREASURY FOR RESNICK AND SAMPLINER
COMMERCE FOR BRZYTWA AND ARONOFF
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SUBJECT: COCA-COLA,S BID FOR JUICEMAKER HUIYUAN BEATEN TO A PULP

REF: 2008 BEIJING 3775

Summary

11. (SBU) China,s Ministry of Commerce (MOFCOM) announced March 18 that it would not permit Coca-Cola,s proposed \$2.4 billion acquisition of Huiyuan, China,s largest fruit juice maker. In its short public announcement on the rejection, MOFCOM cites concerns that Coca-Cola would be able to use its dominant position in the carbonated beverage market to compel distributors and retailers to carry the market-leading Huiyuan brand of juices. MOFCOM also expressed concern about the effect of the combination on China,s small and medium-sized enterprises (SMEs) that compete with Coca-Cola and Huiyuan. The process that drove MOFCOM to its conclusion and its rejection of the deal both highlight the challenges that foreign investors often face in China. These include lack of transparency; China,s arbitrary casting aside of its foreign investment catalogue, which lists fruit drinks in the &encouraged8 category; the influence of competitors on China,s administrative decisions; and the fact that China,s Anti-Monopoly Law (AML) serves to promote China,s economic development as much as competition. China,s rejection of the deal illustrates challenges the U.S. should seek to address in ongoing negotiations with China over a bilateral investment treaty. Coca-Cola reiterated its request that the United States not raise the case with China.

The Proposed Deal

12. (SBU) In September 2008, Coca-Cola reached agreement with

Huiyuan,s four largest shareholders) the company,s Chinese founder, French beverage group Danone, Warburg Pincus, and Fidelity) which collectively control 70% of Huiyuan,s stock. The other 30% of Huiyuan,s shares are listed on the Hong Kong stock exchange. The proposed transaction price represented a 200% premium to the firm,s market value. The contract was dependent upon China approving the transaction within 200 days, a deadline which could be extended if all parties to the transaction agreed. (Note: AML implementing regulations allow China 30 days to review transactions, plus 150 days to conduct more intensive reviews, if needed. End Note.) Coke had never before acquired a firm of Huiyuan,s size in China.

13. (SBU) Coca-Cola was initially cautiously optimistic that China would approve the deal, as reported reftel, which most Western competition experts believed posed few competitive problems. Fruit juice drinks are listed in the encouraged section of China,s Guidance Catalogue for Foreign Investment. At the same time, Coca-Cola China Government Affairs Director Christina Lau told Econ Minister Counselor (M/C) in a March 18 meeting that well-connected Chinese academics had expressed skepticism that the deal would be approved.

Coca-Cola Lacked Access

13. (SBU) Lau told Econoffs Coca-Cola did not lobby aggressively for approval of the deal. Coke,s contacts with

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MOFCOM were almost exclusively at the working level, with AML Bureau Deputy Director Zhu Zhongliang, plus one additional meeting with AML Bureau Director General Shang Ming. Coca-Cola had sought and was unable to obtain access to Vice Premier Wang Qishan, Commerce Minister Chen Deming, and Commerce Vice Minister Ma Xiuhong. Commerce Minister Chen had &fled the scene8 when Lau introduced herself at an Amcham event, she recalled. Coca-Cola had made an internal decision to be quiet and work through official government channels, she added. In addition, Coca-Cola had not approached MOFCOM before announcing the deal to feel out whether it was likely to be approved.

Shocking Lack of Transparency in China,s Review of the Deal

14. (SBU) In an separate March 4 meeting with Econ M/C Luke, Coca-Cola Pacific Deputy President Paul Etchells said that in meetings with Coca-Cola, MOFCOM initially refused to describe its concerns about the transaction,s effects on competition.

Instead, MOFCOM officials said that Coca-Cola had more experience with anti-trust analysis than China, so Coke should &self assess8 the deal and propose mitigating solutions.

15. (SBU) Etchells also expressed frustration that Coca-Cola had &no visibility about what was going on8 at MOFCOM. MOFCOM officials repeatedly declined to update Coca-Cola on the deals status or confirm who was reviewing it. He said there were vague references to higher-level authorities. (Comment: We think it is likely given the size of the transaction that China,s State Council reviewed the deal. In addition, several other Chinese agencies have regulations related to foreign investment and it is not clear what role those agencies may have played as well. End Comment.)

16. (SBU) In addition, Etchells said, while Coca-Cola had notified MOFCOM of the proposed deal on September 18, MOFCOM did not start the clock for its review for many weeks, as it sought additional information. In some instances, MOFCOM would ask for additional information without specifying what additional information it was seeking. In total, through March 4, Coca-Cola had submitted written information 12 times and had 18 further interactions with MOFCOM, he said.

Coca-Cola said MOFCOM had also sought opinions from industry associations and competitors.

China,s Concerns Unrelated to Competition Policy

17. (SBU) Etchells said that Coca-Cola was able to identify some of MOFCOM,s concerns, although MOFCOM never explicitly confirmed them. They were as follows:

(A) Coke,s deal with Huiyuan included a non-compete clause that would have prevented Huiyuan,s founder from establishing or working for a competing business for two years. Coke characterized the clause as a standard clause in merger and acquisition (M&A) transactions. Etchells said this issue seemed to be among MOFCOM,s chief concerns.

(B) MOFCOM was concerned that Coca-Cola was buying off Huiyuan in order to &kill off its brand.8 Etchells said

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that this analysis &made no sense8 since the bulk of the value of Huiyuan was its market-leading brand. (Note: Huiyuan is a bottler. It buys juice and packages it. End Note.) Etchells sensed that this line of reasoning reflected &political pressure8 on MOFCOM. The potential sale of Huiyuan,s brand to a leading foreign firm like Coca-Cola sparked heated opposition to the deal in China,s &blogosphere,8 he added. MOFCOM offered no ideas on how Coca-Cola could reassure it that this was not its plan.

(C) MOFCOM was concerned about the effect of the deal on Coca-Cola,s bottlers, which include one Chinese state-owned enterprise (SOE), COFCO. Etchells said MOFCOM was concerned that China should &give COFCO some benefit of its ownership in Huiyuan,8 like more distribution rights, &but was concerned that Coca-Cola would expect money for this.8 He said MOFCOM also alluded to the idea of transferring Huiyuan manufacturing to COFCO.

(D) MOFCOM also asked Coca-Cola several times why it imports the juice it uses for its Chinese Minute-Maid brand juice drinks and suggested Coca-Cola consider using Chinese-made juice. Etchells said Chinese-made juice is not as high quality as the Brazilian juice that Coca-Cola buys and noted that Huiyuan also uses imported juice in most of its products.

(E) MOFCOM thought that there was a risk that Coca-Cola could use its 50% market position in the carbonated drinks sector to unfairly promote Huiyuan products through tie-ins. (Comment: This concern appears to be the only one relevant to the Anti-Monopoly Law. End Comment.)

18. (SBU) MOFCOM,s press release on the deal refers to concerns about the effect of the deal on small and medium-sized Chinese enterprises and also mentions the tie-in concern, but none of the other issues mentioned above. Our initial attempt to get additional details from MOFCOM regarding its analysis of the case was rebuffed. We will continue to seek information as it becomes available. We are sending separately by email a translation of the MOFCOM press release.

Coke,s Next Steps

19. (SBU) We are unaware of any effective appeal provisions for M&A reviews under China,s Anti-Monopoly Law. In any case, Coca-Cola Pacific Deputy President Etchells told us that if MOFCOM did not approve the deal, it would effectively die. Hong Kong takeover regulations would require Coca-Cola to wait 12 months before re-submitting a revised offer. In addition, declining equity markets would lead Coca-Cola to seek a lower valuation in any future deal, which Huiyuan,s founder likely would be unwilling to accept. That said, Coke Government Affairs Director Lau affirmed that Coke would not

pull back from the China market, which is its third biggest after the United States and Mexico. She added that there are other bidders interested in Huiyuan, some of which had participated in the initial auction, which Coke had won.
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